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No. 95-1348

Supreme Court, U.S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1995

FRED LOWENSCHUSS,
Petitioner

v.

RESORTS INTERNATIONAL, INC.,
Respondent

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

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PETITIONER'S REPLY BRIEF

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PETITIONER'S REPLY BRIEF

Respondent's Brief in Opposition totally side-steps the important issue under the Bankruptcy Code on which the circuits are split and which cries out for resolution through certiorari. It is the question of whether bankruptcy courts have equitable power under section 105(a) of the Bankruptcy Code to confirm Chapter 11 plans of reorganization that release or enjoin claims against non-debtors, or whether bankruptcy courts are totally prohibited from doing so by section 524(e). In its decision in the present case, the Ninth Circuit has erected an Iron Curtain that would forever deprive bankruptcy courts of this valuable tool, which is frequently used to advantage by bankruptcy courts in many other circuits. The obvious conflict

among the circuits on this issue has been recognized by commentators and by the courts themselves, despite respondent's vain attempt to deny its existence. Resorts also ignores the fact that non-debtor releases had been part of its *own* Chapter 11 reorganization, which was confirmed by the U.S. Bankruptcy Court for the District of New Jersey.[1]

The absolute prohibition laid down by the Ninth Circuit would unduly hamstring bankruptcy courts in their fashioning of workable reorganizations, as is clearly demonstrated by the present case. Here we have a situation in which the bankruptcy court, in order to control its own docket and to confirm a plan of reorganization, enjoined a creditor (respondent, Resorts International, Inc.) from proceeding against a non-debtor (the Fred Lowenschuss Associates Pension Plan), *after the creditor had chosen voluntarily to withdraw with prejudice its same claim against the debtor* (Fred Lowenschuss), who was the alleged agent of the non-debtor and upon whose actions the claim against the non-debtor was based.

Although the bankruptcy court had given Resorts the opportunity to try its claim on the merits, Resorts *refused to do so.* Instead, it sought to withdraw its claim "with prejudice," but with the condition that it could reassert the claim later if certain events occurred. Because such conditions would have effectively held the bankruptcy proceedings in limbo, they were correctly rejected by the bankruptcy court. Resorts still refused to try its claim, and instead withdrew the claim *unconditionally with prejudice,* over the debtor's objection. The bankruptcy court then confirmed a plan of reorganization that was primarily funded by the non-debtor (the Pension Plan) and which released and enjoined claims against the Pension Plan. Such an injunction was particularly crucial to the success of the reorganization because Resorts had obtained, in the context of its *own* bankruptcy proceedings, a section 105 injunction that restricted payments from the Pension Plan.

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1. *In re Resorts Int'l, Inc.*, 145 Bankr. 412, 421 (Bankr. D.N.J. 1990). See Petition at 11.

If the bankruptcy court had been allowed to control its docket as it had wished, this matter would have already been concluded. However, Resorts' maneuverings have now tied up petitioner's bankruptcy proceedings for nearly three years. Even more outrageous is Resorts' vicious *ad hominem* attack against petitioner in its Brief in Opposition. Resorts' insinuations of "fraud" are, in reality, based on nothing more than the fact that petitioner, as trustee, had cashed in the Pension Plans' shares of Resorts stock *in accordance with the terms of Resorts' own tender offer*, which Resorts thereafter asserted was in violation of Delaware state law. See Petition at 4-5. Furthermore, it is supreme hypocrisy for Resorts to impugn petitioner for failing to turn over Pension Plan assets to his ex-wife pursuant to a state court order, when *Resorts itself* had obtained a bankruptcy court order to *enjoin* such payments from the Pension Plan. Resorts is, in fact, trying to undermine the very reorganization plan that is making payments to petitioner's ex-wife possible.[2]

As pointed out in the Petition, this is a particularly appropriate opportunity for the Supreme Court to review the issue of non-debtor releases and injunctions, because this is likely to be the last such case from the Ninth Circuit, due to the blanket prohibition expressed in the Ninth Circuit's opinion.

I. The Split Among the Circuits Has Been Recognized by the Circuit Courts and Commentators Alike.

While respondent claims that there is no conflict among the circuits on the issue of a bankruptcy court's power to grant non-debtor releases, respondent concedes in its brief that the Second and Fourth Circuits have "affirmed injunctions preventing suits against non-debtors." Respondent's Brief at 9. In

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2. See Petitioner's Appendix at 25a-32a. Resorts is not only attempting to prevent the Pension Plan from making further payments under the plan of reorganization, but also to require the trustee to personally repay all distributions made in accordance with the plan. See Petition at 7.

addition, Respondent's brief fails to address the fact that the Fourth, Fifth, and Seventh Circuits have all departed from the Ninth Circuit in refusing to read section 524(e) as an absolute prohibition against non-debtor discharges.[3]

Respondent has erroneously stated that "there is no conflict among the circuits on the issue of a bankruptcy court's authority to release or discharge a non-debtor because no Court of Appeals has actually affirmed such a release or discharge." Respondents Brief at 7. Yet Respondent admits that circuit courts have affirmed non-debtor discharges in the *Johns-Manville, A.H. Robins,* and *Drexel* cases.[4] Respondent's Brief at 8-12. Respondent has attempted to differentiate between non-debtor releases and permanent injunctions, although the circuit courts have held that no distinction should be made between the two.[5]

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3. See, e.g., *In the Matter of Specialty Equipment Companies, Inc.*, 3 F.3d 1043, 1046-1047 (7th Cir. 1993); *In re A.H. Robins, Inc.*, 880 F.2d 694, 702 (4th Cir. 1989); *Republic Supply Co. v. Shoaf*, 815 F.2d 1046, 1050 (5th Cir. 1987) (section 524(e) does not by its specific words preclude all non-debtor discharges, which have been accepted and confirmed as an integral part of a plan of reorganization).

4. Respondent attempts to distinguish the cases of *MacArthur Co. v. Johns-Manville Corp. (in re Johns-Manville Corp.)*, 837 F.2d 89 (2d Cir.), *cert. denied*, 488 U.S. 868 (1988), *Menard-Sanford v. Mabey (In re A.H. Robins Co.)*, 880 F.2d 694 (4th Cir.), *cert. denied*, 493 U.S. 959 (1989), and *In re Drexel Burnham Lambert Group*, 960 F.2d 285 (2d Cir. 1992), *cert. dismissed, sub nom., Hart Holding Co. v. Drexel Burnham Lambert Group*, 113 S.Ct. 1070 (1993), from the petitioner's case. However, the commonality of the cases is that the release of the non-debtor entity was necessary for a successful reorganization. In this case, the non-debtor pension plan is contributing over three million dollars to the plan of reorganization, without which funding a reorganization would not be possible.

5. See, e.g., *American Hardwoods, Inc. v. Deutsche Credit Corp. (In re American Hardwoods, Inc.)*, 885 F.2d 621, 626 (9th Cir. 1989)(noting that Section 524(a)(2) of the Bankruptcy Code describes a discharge as an injunction and concluding that a discharge is a special kind of permanent injunction); *See also* Boyle, *Non-Debtor Liability in Chapter 11: Validity of Third-Party Discharge in Bankruptcy*, 61 FORDHAM L. REV. 421 (1992), which states: "In effect a discharge is an injunction, and any attempt to distinguish the two is an unpersuasive semantic exercise." *Id.* at 429.

In addition, the circuit courts themselves, as well as legal commentators, have recognized the difference in treatment among the various circuits on the issue of non-debtor releases. In *Monarch Life Ins. Co. v. Ropes & Gray*, 65 F.3d 973 (1st Cir. 1995), a case cited by respondent in its Brief in Opposition, the Court of Appeals affirmed the district court's upholding of the bankruptcy court's release of a non-debtor and discussed at length the two conflicting lines of cases with respect to non-debtor releases.[6] In addition, various law review articles have noted the split in the circuits and have discussed the different approaches to non-debtor discharges.[7] The number of bankruptcy courts throughout the country which have used non-debtor releases in confirming plans of reorganization is nothing short of astounding. See Petition at 8, n.7. Therefore, any attempt by respondent to deny that such a split in authority exists among the circuits is misplaced if not disingenuous.

The Ninth Circuit's blanket prohibition against non-debtor releases is in conflict with the circuit courts that have refused to read section 524(e) as absolutely precluding the release of non-debtors. This has raised an issue of national importance as to whether bankruptcy courts will be allowed to use non-debtor releases as a tool to fashion workable reorganizations in appropriate cases.

II. The Release of the Pension Plan Was Warranted Because Resorts Voluntarily Withdrew Its Claim with Prejudice.

Respondent argues that no circuit would affirm the release in this case because it effectively extinguishes Resorts' claim. Respondent's Brief at 12-13. However, the Bankruptcy Court's release of the Pension Plan was fully warranted because Re-

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6. *Monarch, supra*, 65 F.3d at 979-980.

7. *See, e.g.*, Leal, *The Power of the Bankruptcy Courts: Section 105*, 29 S. TEX. L. REV. 487 (1988); Cook and Brener, *Third-Party Releases in Chapter 11 Reorganization Plans*, 611 PLI/COMM. 369 (1992), Han, *Testing the Limits of Judicial Discretion in Chapter 11: The Doctrine of Necessity and Third Party Releases*, 94 ANN. SURV. AM. L. 551 (1994).

sorts' itself had *voluntarily withdrawn its claim with prejudice.*[8] Resorts had pursued the debtor for three years as a creditor of petitioner's bankruptcy and, on the eve of the trial of its claims, Resorts chose to withdraw its claims on the condition that it be able to reassert them if the Pension Plan was later determined to be property of the bankrupt estate. See Petition at 6. The Bankruptcy Court properly instructed Resorts either to litigate its claims on the merits or to withdraw its claims without condition. Because Resorts chose to withdraw unconditionally with prejudice, it was perfectly proper and equitable for the Bankruptcy Court to release the Pension Plan.

Furthermore, the Bankruptcy Court was justified in enjoining actions by Resorts against the Pension Plan, under the analysis of part three of the *Otero Mills* test for granting a non-debtor injunction (Petition at 12-13). *In re Otero Mills, Inc.*, 21 Bankr. 777 (Bankr. D.N.M. 1982), *aff'd*, 25 Bankr. 1018 (D.N.M. 1982). Under part three of the *Otero Mills* test, release of the Pension Plan would result in "no harm or minimal harm" to Resorts because Resorts claim against the Pension Plan was already extinguished by its voluntary withdrawal with prejudice (See Petition at 13, n.15.)[9] In addition, the injunction was necessary to prevent Resorts from blocking the use of Pension Plan assets to fund the reorganization.

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8. Debtor requested that Resorts be required to litigate its claim. The Bankruptcy Court, *over Debtor's objection*, allowed Resorts to voluntarily withdraw its claim with prejudice.

9. Resorts voluntarily withdrew with prejudice its claim against debtor, whom it alleged to be acting as the agent of the Pension Plan in committing the alleged wrong. Because the release of an agent releases of the principal, collateral estoppel would bar Resorts' claim against the Pension Plan as well. Respondent does not dispute the merits of the *Otero Mills* test in determining when non-debtor injunctions may be appropriate. Nor does respondent dispute the fact that Petitioner would satisfy this test.

III. Section 524(g) of the Bankruptcy Code Does Not Affect Bankruptcy Courts' Authority To Release Non-Debtors in Non-Asbestos Cases under Section 524(e).

Respondent's Brief in Opposition further highlights how the Ninth Circuit has misconstrued subsection 524(g) (recently added by the Bankruptcy Reform Act of 1994) in attempting to bolster its interpretation of subsection 524(e) of the Bankruptcy Code. Because subsection 524(g) specifically provided for non-debtor releases in only a limited class of asbestos cases, the Ninth Circuit inferred that subsection 524(e) must therefore deny authority in other kinds of cases. See Petitioner's Appendix at 20a, n.6, and Respondent's Brief at 16. However, such an interpretation is directly contradicted by the congressional committee report accompanying the amendment, which expressly states that section 524(g) was "*not intended to alter any existing authority bankruptcy courts may already have to issue injunctions in connection with a plan of reorganization.*" 140 Cong. Rec. H 10,765 (October 4, 1994) (emphasis added). See Petition at 14-15. Thus, the legislative history of section 524(g) clearly establishes that Congress did not view section 524(e) as a blanket prohibition against non-debtor releases.

IV. There Has Been No "Unappealable Ruling" that the Nevada Bankruptcy Court Lacked Subject Matter Jurisdiction To Grant the Non-Debtor Release.

Respondent's assertion that there has been a "final and unappealable ruling" that the Nevada Bankruptcy Court lacked subject matter jurisdiction to release the Pension Plan (Brief in Opposition at 18-19) is blatantly incorrect. Neither the Ninth Circuit nor the District Court ever stated that the Nevada Bankruptcy Court lacked subject matter jurisdiction to release the Pension Plan in this case.

Rather, the Ninth Circuit merely stated that "Lowenschuss has waived consideration of the issue of whether the bankruptcy court improperly retained jurisdiction over *future litigation* of Resorts' claim against the Pension Plan..." Petitioner's Appen-

dix at 20a (emphasis added). This question of the Bankruptcy Court's retention of jurisdiction over *future* litigation is not relevant to the issues Petitioner has raised and has nothing to do with whether this Court should grant certiorari in this case. In contrast, the specific issue of whether the bankruptcy court had power to release or enjoin actions against the Pension Plan was obviously preserved for appeal — or else it would not have been addressed by the Ninth Circuit.

CONCLUSION

The issue of whether bankruptcy courts have the equitable power to release or enjoin claims against non-debtors is undeniably one of first impression before this Court. It is a question of national importance that is ripe for review and on which the circuits are deeply divided. Therefore, the petition for a writ of certiorari should be granted.

Respectfully submitted,

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